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No. 53.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

GOOCH MILLING & ELEVATOR COMPANY, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR RESPONDENT.

F. W. MCREYNOLDS,
and
D. M. KELLEHER,
Attorneys for Respondent.

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OPINION BELOW.

The opinion of the Circuit Court of Appeals (R. 27-38) is reported in 133 Fed. Rep. (2d) 131.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on January 29, 1943 (R. 21). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

The question presented is whether the Board of Tax Appeals in redetermining a deficiency for 1936 had jurisdiction to give effect to a defense to the 1936 deficiency based on the doctrine of equitable recoupment. An outline of the facts is as follows: Because of an error in the amount, the Commissioner adjusted, by a reduction, taxpayer's June 30th, 1935 inventory, resulting in an increase of tax for the fiscal year 1936. The inventory was common to successive tax years, being the closing inventory for the fiscal year 1935 and the opening inventory for 1936. The adjustment reduced the tax liability for 1935 (which taxes had been paid), by an amount greater than the 1936 deficiency. As determined by the Commissioner, and found by the Board on redetermination, the facts established the defense of recoupment which a court would sustain. The question presented, therefore, is whether upon a redetermination by the Board its jurisdiction is so restricted that the same effect could not be given to a defense to the 1936 deficiency that a court would give.

STATUTES INVOLVED.

The statutes involved are set forthin the appendix infra, pp. 20, 21.

STATEMENT.

The Board of Tax Appeals reviewed the Commissioner's determination of a deficiency for the fiscal year 1936, and held it had "no jurisdiction to consider the defense raised by the petitioner" (R. 11). The Commissioner determined that there was an error in the taxpayer's June 30th, 1935 inventory—the closing inventory for the fiscal year 1935 and the opening inventory for 1936. This inventory, common to successive tax years, the Commissioner adjusted to conform to the Revenue Agent's report, by subtracting

from the taxpayer's inventory the amount of $237,104.33. This inventory reduction resulted in a deficiency for 1936 of $6,663.42, after allowance for certain payments made by the taxpayer. The change in inventory figures according to the Revenue Agent's report and as the Board found, also resulted in "an over-assessment for the fiscal year 1935 of $7,935.58," (R. 11) an amount greater than the 1936 deficiency as determined. The 1935 tax computed upon the basis of the erroneous June 30th, 1935 inventory had been paid. (R. 16) When the inventory error was discovered and corrected, a claim for refund was barred by limitations statutes. The inventory change both reduced the tax liability for 1935 and increased it for 1936. Except for the reduction in the June 30th, 1935 inventory, there would be no deficiency.

The taxpayer in an amendment to its petition lodged with the Board pleaded the right of recoupment as a defense to the claim of a deficiency for 1936. Its motion for leave to amend (R. 9) was denied on the sole ground that the Board had no jurisdiction in redetermining the deficiency, to sustain a defense to the 1936 deficiency based on the right of recoupment. (R. 11)

The Revenue Agent's report, accepted by the Commissioner as the basis for his determination, showed an overassessment for 1935 of $7,935.59 (R. 17), and this fact appears in the findings of the Board. (R. 11) Although there were overpayments exceeding $8,000 for tax years 1928 to 1934, also due to inventory errors, such overpayments need not be considered in order to support the claim of recoupment, because the overpayment for 1935 alone exceeds the 1936 deficiency. (R. 11)

The principal facts are set forth in the findings of the Board as follows:

1. "Petitioner's balance sheet for the taxable year shows an opening inventory of $361,701.88, and a closing inventory of $345,017.43. The deficiency letter shows that respondent

reduced petitioner's opening inventory at July 1, 1935 by the following adjustment, 'inventory adjustment, June 30th, 1935, $237,104.33.' The deficiency herein results primarily from this adjustment of petitioner's inventory." (R. 11)

2. "Following the death of petitioner's president on June 11, 1938, an audit of petitioner's books revealed that all inventories as far back as 1928 were erroneous. The reduced inventory was first computed by petitioner's accountants and was accepted by respondent as the basis for the present deficiencies." (R. 11)

3. "Based upon corrected inventories the petitioner had over-paid its income taxes for all the years 1928 to 1934, inclusive, in a net sum in excess of $8,000. The revenue agent's report for the fiscal year 1935 shows an overassessment for the fiscal year 1935 in the sum of $7,935.58, which amount is not subject to refund because barred by the Statute of limitations." (R. 11)

On a petition to review the decision of the Board, the Court of Appeals for the Eighth Circuit reversed the Board (now The Tax Court of the United States), 133 Fed. (2d) 131.

SUMMARY OF ARGUMENT.

1. Petitioner's argument, summarized on pages five to seven of the brief, contends that the Board has "no general jurisdiction" and is not an agency empowered "to settle generally the tax account between an individual and the Government"; that its sole function is to review "certain restricted classes of proposed assessments", leading to the conclusion that although the facts considered in redetermining the deficiency show a defense a court would uphold, the taxpayer deprives himself of his right to this defense on appeal to the Board, because "the Board is without power to apply any overpayments for prior years against the liability for the fiscal year 1936". No distinction is made in the argument for petitioner between cases where

the facts support a defense to the deficiency under investigation based on the right of recoupment, and cases where the facts would support only an affirmative demand for refund.

2. A fair construction of Section 274 (g) of the 1926 Act (Section 272 (g) of the Internal Revenue Code) is that in following the statutory mandate to consider the tax liability for "other taxable years", the facts found on investigation are to be given such effect as "may be necessary to correctly redetermine" the deficiency for the year under investigation, and when the facts establish a full defense to a deficiency determined by the Commissioner, and no affirmative order for a refund or credit is necessary, the Board has power to sustain such defense in the exercise of it's jurisdiction to redetermine the deficiency.

3. The Board has full power to redetermine the deficiency claim or demand determined in the first instance by the Commissioner. The power of the Board in such redetermination is not more restricted than is the power of the Commissioner in his determination. That the Commissioner should sustain a defense based on the right of recoupment is proved by the fact that in a court proceeding his denial of such defense will be held erroneous.

4. A taxpayer who has a good defense to a claimed deficiency is entitled to have that defense recognized in the first instance by the Commissioner. The Commissioner should not deny the defense in the expectation that the jurisdiction of the reviewing tribunal will be narrower than his own. Obviously it is the Commissioner's duty to decide according to the legal rights of the taxpayer, and the presumption should be indulged that a tribunal created to redetermine the deficiency has jurisdiction to do what the Commissioner should have done.

5. In weighing the facts, the Commissioner must consider and give due weight to any legal defense. The right of re-

coupment is such defense. Concededly the defense is not lost to the taxpayer by the Commissioner's refusal to recognize it. It is merely contended that the Commissioner's error can be corrected only if the taxpayer pays the erroneously determined tax and sues in court to recover. The Board of Tax Appeals was created to assure the taxpayer correction of the Commissioner's errors by appeal to the Board before paying the tax, and its jurisdiction upon redetermination was intended to be co-extensive with that of the Commissioner.

ARGUMENT.

Respondent contends that the right of equitable recoupment is available to the taxpayer in redetermination proceedings before the Board as a defense to the demand of a deficiency for 1936. That it was the duty of the Board to consider the "facts with relation to the taxes for other taxable years" in order to redetermine the 1936 deficiency.

The facts sustaining the right to recoupment are not in dispute, and are in substance contained in the findings of the Board. The facts which establish the defense of recoupment originate in the adjustment of the error in the June 30th, 1935 inventory, the same transaction upon which is based the determination of a 1936 deficiency. There was such direct connection between the tax liabilty for the consecutive fiscal years 1935 and 1936, in which the same inventory was a basic factor for computation of the tax liability for each of said years, that when the inventory reduction was determined upon by subtraction of $237,104.33 from the inventory figures, the 1935 tax liability was reduced by an amount which the facts and findings show exceeded the 1936 deficiency resulting from the inventory reduction. These facts called for the application of the doctrine of recoupment by way of a defense to the 1936 deficiency and should not, as petitioner's brief assumes, be limited in effect to supporting an affirmative right to demand a refund for the overpaid 1935 tax, no longer available because

of the limitation statute. The facts and circumstances established *a complete defense* to the 1936 deficiency tax claim.

The right of equitable recoupment is not a set-off or counterclaim, but an equitable reason which inheres in the transaction out of which the deficiency claim springs and is strictly a defense.

Williams v. *Neely*, 134 Fed. Rep. 1, 5.
Crossett Lumber Co. et al. v. *United States*, 87 Fed. Rep. (2d) 930, 933.
Stone v. *White*, 301 U. S. 532.
Bull v. *United States*, 295 U. S. 247.

Determination of tax liability where the right of recoupment is in issue is governed by equitable standards. Without regard to the bar of limitations statutes, defenses which inhere in the same facts upon which liability is predicated, open the door to the taxpayer "to show any state of facts which according to those standards would deny the right."

Stone v. *White*, 301 U. S. 532, 81 L. Ed. 1265.
Bull v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.
Crossett Lumber Co. et al. v. *United States*, 87 Fed. Rep. (2d) 930, 933.
Mills v. *United States*, 35 Fed. Supp. 535.
Dixie Margarine Co. v. *Commissioner*, 115 Fed. Rep. (2d) 445.

The doctrine of recoupment is not available to support an affirmative demand barred by limitation, such as a claim for refund, but is available as a defense to a new tax demand which arises out of the same transaction.

Dixie Margarine Co. v. *Commissioner*, 115 Fed Rep. (2d) 445.
Crossett Lumber Company et al. v. *United States*, 87 Fed. Rep. (2d) 930, 933.
Bull v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.

There is as direct connection "between income taxes paid in successive years based upon a single erroneous inventory

as there was between the estate tax erroneously determined and income tax correctly determined on the same item in *Bull* v. *United States, supra.*" *Crossett Lumber Co.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.

Had the petitioner paid the 1936 deficiency and sued to recover, it is a fair inference from the position taken by counsel for the Commissioner in the Court of Appeals and here, that the legal sufficiency of the defense by way of recoupment would be conceded. It is our contention that the Commissioner in the first instance should not determine that a deficiency exists if such determination would be reversed by a court called upon to review the finding and decision of the Commissioner; and that the Board's power on redetermination is co-extensive. It is not conceivable that the Congress intended the officials charged with administrative duties should make determinations which, when challenged in a court, would be reversed because contrary to the legal rights of the taxpayer. It is only when the facts show no defense to the deficiency demand, but are only sufficient to support an affirmative demand for a refund barred by limitations, that the Commissioner's determination is governed by a rule of law similar to the rule invoked in the Petitioner's brief.

Under Section 3774 of the Internal Revenue Code, a refund is erroneous if a claim for refund is not filed within the period of limitations. But, as was recognized in *McEachern* v. *Rose*, 203 U. S. 56, Sections 3774 and 3775 do not apply "in the circumstances disclosed in *Stone* v. *White*, 301 U. S. 532." It follows that when the facts warrant the application of the doctrine of recoupment, as is true here, the determination must be made with due regard to the nature of the right of recoupment. This is because a taxpayer entitled to recoupment is entitled to his defense to the demand or claim for a deficiency and need not resort to a claim for refund. The defense is available where, as here, it inheres, and has its origin in the same transaction which gives rise to the demand, and springs from the very sub-

ject matter upon which the deficiency claim is based. The fact that a refund would be erroneous because barred by limitations, is not controlling. It is of the essence of the right to recoupment that it is in the nature of a defense to a claim. Statutes designed to cut off stale or barred demands do not deprive a taxpayer, any more than any other litigant, of his defenses.

The right of recoupment, when established by the facts, is as much a legal defense as any other defense, and is not barred by the limitations statutes which bar a claim for refund. As the court in *Stone* v. *White*, 301 U. S. 552, said: "The statutory bar to the right of action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover."

The argument for Petitioner that the Board lacks jurisdiction to give effect to facts constituting a good defense to the 1936 deficiency based upon taxpayer's right of recoupment, must mean that upon redetermination by the Board its power is more restricted than that of the Commissioner. The Commissioner's determination of a deficiency would then be right or wrong, according to whether the taxpayer appealed for redetermination by the Board; or paid the tax, asked a refund, and sued in court. The Board of Tax Appeals was created for the express purpose of assuring the taxpayer a redetermination by the Board before assessment of the tax. The procedure was devised as a measure of relief to taxpayers from burdens imposed by the earlier exclusive method of reviewing the Commissioner's determination by action in court after assessment and payment. A partial redetermination by the Board, excluding the issue that there is no deficiency owing because the facts show a defense to an assessment in any amount, would not accomplish the purpose for which the Board was established.

The argument that the defense of recoupment cannot be considered as within the Board's jurisdiction is contrary to the decision in *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445, 447. In that case upon a petition to review the Board's decision involving the application of the principle of recoupment, it was held: "The Board had no occasion to consider whether the statute of limitations affected the availability of petitioner's claim in recoupment. We think it did not."

Petitioner's brief reviews the history of the administration of tax laws before the creation of the Board of Tax Appeals, and in effect argues that the Board's jurisdiction should be narrowly restricted in redetermining deficiencies, because originally an error of the Commissioner could not be reviewed except by a court.

Judicial pronouncements, however, are to the effect that the jurisdiction of the Board to redetermine tax liability is co-extensive with that of the Commissioner, as the following citations show:

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that if may determine or redetermine the correct amount of the tax." *Houston Street Corp.* v. *Commissioner*, 84 Fed. Rep. (2d) 821, 822.

The proceeding for redetermination by the Board "is in nature similar to, and is of equal formality with a suit to recover a tax paid." *Bishoff* v. *Commissioner of Internal Revenue*, 27 Fed. Rep. (2d) 91, 93.

In view of the purpose for which the Board is established, "it has equal power to do full justice to the parties" that a court would have. *Helvering* v. *Edison Securities Corp.*, 78 Fed. Rep. (2d) 85, 91.

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that it may determine or redetermine the correct amount of the tax." *Peerless Woolen Mills* v. *Rose*, 28 Fed. Rep. (2d) 661, 662.

While the Board is an independent agency in the executive branch of the Government, the appellate powers conferred upon the Board are judicial in character. *Blair* v. *Osterlein Machine Company*, 275 U. S. 220. *Champlin* v. *Commissioner*, 78 Fed. Rep. (2d) 905, 907 (C. C. A. 10th) states that, "The Board, when its jurisdiction is properly invoked, has power to revise legal errors of the Commissioner whether they be for or against the taxpayer." The jurisdiction conferred to redetermine the deficiency is broad enough to empower the Board to sustain a defense to the deficiency without a special grant of jurisdiction enumerating all possible defenses that the facts in any case appealed may support.

And, on petition to review the Board's decisions, the Courts are by statute required to determine whether the "decision of the Board is in accordance with law." Internal Revenue Code Section 1141 (c) (1). A redetermination which denies a defense that would prevail in a court clearly is not "in accordance with law."

The doctrine of recoupment is applicable to tax controversies. It is immaterial how the parties are arrayed in the proceeding, as a fact-supported defense of recoupment operates alike to defeat claims of the Government and the taxpayer. The defense is not barred so long as the main action is timely. The authorities are unanimous that because the right of recoupment arises out of the same facts as the claim, demand, or cause of action itself, it is a good defense.

The Board had general jurisdiction to redetermine the 1936 deficiency and, if the facts warranted, to determine there was no deficiency. In the redetermination proceeding it appeared that the change or adjustment of the June 30th, 1935 inventory was necessary to support the deficiency, but if the doctrine of recoupment applied, the same facts supported a defense to the deficiency. If the Board must disregard a defense based on the doctrine of recoupment (which a court would sustain), the procedure prescribed

by law would surely mislead the taxpayer. The law requires a notice to the taxpayer of his right to redetermination by the Board before a tax is assessed. Upon appealing for a redetermination in compliance with the notice, he is barred from any action in court other than a court review of the Board's decision. Internal Revenue Code Section 322 (c). *Cook* v. *United States*, 108 Fed. (2d) 804, 806 (C. C. A. 2nd).

Jurisdiction under the statute was vested in the Board to consider the facts "with relation to the taxes" for 1935, if such consideration had a bearing upon the performance by the Board of its duty "correctly to redetermine" the amount of the 1936 deficiency. In the exercise of this jurisdiction, the Board did consider these facts "with relation to the taxes" for 1935. Before the 1936 tax could be computed at all, it was absolutely necessary to determine the closing inventoryq for 1935; there was no other way of ascertaining the opening inventory for 1936.. The facts and findings establish the existence of the equitable reason which inheres in the transaction out of which the deficiency claim springs, constituting a defense to the 1936 deficiency. The claim for a 1936 deficiency and the defense to the claim called the right of recoupment, have their origin in the same transaction—the erroneous inventory.

When the Commissioner determined, and the Board redetermined, the June 30th, 1935 inventory, the consequences which followed should not be viewed as split in two unrelated parts, and given effect as creating a 1936 tax demand or debt, and ignored as establishing a legal defense to the same debt. The power conferred upon the Board to "consider facts with relation to the taxes for other taxable years" must mean the power to consider the effects of such facts as a defense to an apparent deficiency for the year under investigation. Unless such facts had some effect upon the taxes for the year under investigation, their "consideration" would be futile. If given any effect, they should be given every effect the rules of law recognize. If

the facts reduce the deficiency or reveal a full legal defense, that result is within the power of the Board to find and declare. As the opinion of the Court of Appeals states, the Board may not order a refund, and no redetermination requiring such order was asked. It was only necessary for the Board to determine whether the apparent deficiency and the facts supporting the right to recoupment had a common origin or source, which in this case was apparent on the face of the transaction.

Petitioner's argument that although the Board is required to consider "such facts with relation to the taxes of other taxable years," necessary for a correct redetermination (Section 272 (g) of the Internal Revenue Code) the proviso, "but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid" withdraws from the Board power to correct the errors of the Commissioner in the proceeding under review.

The enacting clause of this statute confers jurisdiction upon the Board to redetermine the issue and the facts considered by the Commissioner, and specifically to consider such facts with reference to the taxes for other taxable years "as may be necessary correctly to redetermine the amount of such deficiency."

The reason for the proviso, we submit, is to limit the effect of "such facts" to the deficiency for the year involved in the appeal. The Board could not order a refund. If, however, the Commissioner should have determined that the facts established a defense to the deficiency, the Board could correct the error in its redetermination.

The right of recoupment, limited as it is to the transaction out of which the determination of a deficiency arises, and therefore a defense inhering in the Government's claim for the deficiency tax, is an available defense which must either prevail or be rejected in redetermining the deficiency. If the right to equitable recoupment could be asserted only as a cross demand, or by way of claim for refund, the con-

tention as to the application of the proviso to the facts would be supported by a more persuasive argument than the one urged. The proviso must be strictly construed and not only must the facts be within the letter of the proviso, but within its reason.

The body of the act contemplates a redetermination of the 1936 tax liability by the Board. The enacting clause is general. Under settled rules of construction, the proviso must be construed strictly. No case is taken out of the enacting clause unless it falls clearly within the proviso. A proviso carves special exceptions only out of the general enacting clause. *United States* v. *Dickson*, 15 Peters (40 U. S.) 141; *Ryan* v. *Carter*, 93 U. S. 78.

The Petitioner's argument seeks by construction to limit the enacting clause to situations such as a redetermination where there are net losses carried over to the succeeding tax year, consideration of invested capital and questions pertaining to deductions for depreciation. The words of the Act, however, do not so limit the Board in its investigation of the facts preliminary to the redetermination of the taxpayer's liability for the deficiency. The mandate to the Board to consider the facts with relation to the taxes of other taxable years is in general terms.

A careful reading of the section, we submit, indicates that the Board has power to make any redetermination as to the 1936 deficiency which the facts warrant, and to correct any error that inheres in the Commissioner's determination. For that purpose it is the duty of the Board to consider all the facts pertaining to the taxes for other taxable years. But, its "determination" is a determination of the 1936 deficiency. A determination, as the term is used in the Revenue Acts, is an administrative act which, as the Court said in *Bull* v. *United States*, 295 U. S. 274, 79 L. Ed. 1421, is the equivalent of a judgment. This judgment the Board enters only as it concerns the year for which the Commission has determined a deficiency.

The narrow question stated as the question to be decided in *McEachern* v. *Rose*, 302 U. S. 56, was whether the overpayments "are so related" to the tax that should have been, but was not, assessed, as to preclude recovery. Here they are so related. This, we submit, is the test, and the McEachern case, we submit, is not authority to the contrary.

Statutes of the State of New York and of Wisconsin, which in terms come closer to cutting off a right of recoupment than the statute under consideration, have been construed as not destroying the defense of recoupment.

The Wisconsin statute is Wisc. Stat. Section 330.27, which provides that "a cause of action upon which an action cannot be maintained, as prescribed in this chapter, cannot be effectually interposed as a defense, counterclaim or set-off."

A similar statute of the State of New York (omitting the word "set-off") has also been construed as not depriving a defendant of his defense of recoupment. Notwithstanding the statute, a defendant may show any facts which reduce or defeat the plaintiff's claim including the defense of recoupment.

> *Peterson* v. *Feyereisen*, 203 Wisc. 294, 73 A. L. R. 571, 573, followed in *Webb* v. *American Surety Company*, 88 Fed. Rep. (2d) 171, 174, and in *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. 445, 448, where the same question was involved as in the instant case.
>
> *Kelly Asphalt Block Co.* v. *Brooklyn Alcatraz Asphalt Co.*, 190 App. Div. 750, 180 N. Y. Supp. 805.
>
> *Marsh* v. *Richer*, 68 Misc. Rep. 587, 125 N. Y. 245.

The basis of the doctrine of recoupment is that principle of natural justice which forbids the enforcement of demand to which there is a defense growing out of the same trans-

action. A demand arising from the correction of an error in a case where due to the same error, the creditor has previously been overpaid, arises out of the same transaction.

" 'Transaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship." *Moore* v. *New York Cotton Exchange*, 270 U. S. 593, 45 A. L. R. 1370, 1378.

It is open to the taxpayer to show "any state of facts" which identifies the defense as springing from the same source as the demand. When such facts appear, the defense is not barred by limitations if the creditor's demand is timely. The defense of recoupment does not succeed by revival of a stale claim in the nature of a cross-demand, but because the demand itself is unjust. In this case the facts were before the Commissioner and the Board. The Commissioner accepted the report of the Revenue Agent showing the overassessment for 1935 of $7,935.58, as set out in Exhibit 4 received in evidence (R. 15), and which shows "an over-assessment of income tax for the year ending June 30th, 1935 of $7,935.58." (R. 16)

Petitioner argues that the Board has no equity powers, and for that reason in redetermining a deficiency could not give effect to a right of recoupment; also that the remedy by way of recoupment is not available until both the amount of the creditor's claim and the sum asked to be recouped are established in some prior proceeding. We contend that the principle of recoupment is of common law rather than of equity origin, and that it is frequently applied where the amount of the demand and the amount asked by way of recoupment are for the first time presented for determination in the proceeding in which the defense of recoupment prevails.

"Recoupment, however, is in the nature of a common-law defense, and differs from set-off and counterclaim mainly in that the claim upon which it is based must grow out of the very same transaction which furnishes the plaintiff's cause of action, and, being in the nature of a claim to reduce the amount demanded, recoupment can be had only to an extent sufficient to satisfy the plaintiff's claim, * * *." (Annotation to *United States* v. *National City Bank*, 106 A. L. R. 1242)

"While the remedy is of common-law origin, it is an innovation on the strict rules of the common law; it may be employed in equity, and, in some states, it is the subject of code or statutory provisions. The right to recoup has not been abolished by the code provisions. Even in states wherein the codes do not specifically mention recoupment as a form of pleading, the right to recoup still exists, * * *." 57 C. J. 358.

In *Edgemoor Iron Co.* v. *Brown Hoisting Machine Co.*, 22 Del. 10, it is said:

> "The doctrine of recoupment was recognized and allowed at common law, and was and is applied to actions whether founded in contract or in tort, but it is limited as a defense to defeating the plaintiff's action, in whole or in part."

Cooley, J. in *Chandler* v. *Childs*, 42 Mich. 128, discussing the application of the doctrine of recoupment where the respective claims of the plaintiff and defendant were both unliquidated and the amounts could only be fixed in the process of determining the issues, said:

> "It is always objectionable to make a substantial defense depend upon the form of action the plaintiff may have chosen to adopt, and we agree with the Supreme Court of Massachusetts that recoupment is as applicable in cases of tort as in cases of contract. Carey v. Guillon, 105 Mass. 18."

In *McHardy* v. *Wadsworth*, 8 Mich. 349, 353, Judge Christiancy said:

> "A defense, by way of recoupment, denies the validity of the plaintiff's cause of action to so large an amount as he claims. It is not an independent cross-claim, like a separate and distinct debt or item of account due from the plaintiff, but is confined to matters arising out of, or connected with, the contract or transaction which forms the basis of the plaintiff's action."

The Court of Appeals for the Sixth Circuit in *Skud* v. *Tillinghast*, 195 Fed. Rep. 1, 8, answering a contention that the remedy by way of recoupment was in equity, said:

> "It was held below that Skud's remedy is in equity; but that is not his only remedy. He may have any damages he has suffered through loss of the stock, applied in reduction of the indebtedness due upon his promise. If such a defense is not within the doctrine of set-off as it exists under the statute and the practice of Michigan, it seems clear that it is within the doctrine of recoupment under the statute of the state and the practice in that behalf."
>
> "Set-off and recoupment are by no means the same defense. * * * The latter is not statutory, but a principle of the common law, by which the defendant may reduce the plaintiff's claim, even to the extent of cutting it out entirely, by showing that, by reason of the plaintiff not complying with the obligation resting on him by virtue of the contract or transaction sued on, loss or injury has occurred to the defendant." Merchants' Bank v. Acme Lumber & Mfg. Co., 160 Ala. 435, 49 So. Rep. 782, 784. See also Waterman Set-Off, Recoupment and Counterclaim 2nd Ed., Section 464.

The jurisdiction to consider the defense of recoupment is not peculiar to courts of equity; nor is the right of recoupment interposed as a defense dependent upon the prior determination of the amount for which recoupment is asked. The defense has frequently been upheld in ordinary actions at law. Likewise, it has been held in cases where one or

both of the claims in issue were for amounts determined only in the proceeding in which recoupment was interposed as a defense.

CONCLUSION.

The Respondent is merely asking that well established principles be applied to prevent the exaction of a debt it does not owe, and which is barred from refund if such exaction is permitted. The Commissioner erred in determining a deficiency for 1936, which error the Board should have corrected on redetermination, as the Circuit Court of Appeals decided.

Respectfully submitted,

F. W. McREYNOLDS,
and
D. M. KELLEHER,
Attorneys for Respondent.

October, 1943.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680, provides:

Sec. 272. PROCEDURE IN GENERAL.

(a) (1) Petition to Board of Tax Appeals.—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. • • •

• • • • • • • • • • •

(b) Collection of Deficiency Found by Board.—If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

• • • • • • • • • • •

(e) Increase of Deficiency After Notice Mailed.—The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

• • • • • • • • • • •

(g) Jurisdiction Over Other Taxable Years.—The Board in redetermining a deficiency in respect of any taxable year

shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Revenue Act of 1926, c. 27, Sec. 1003 (a) and (b), 44 Stat. 110, provides:

Courts of Review.—(a) In General. The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board, * * *

* * * * * * * * * * *

(c) Powers—(1) To affirm, modify, or reverse. Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

SUPREME COURT OF THE UNITED STATES.

No. 53.—October Term, 1943.

Commissioner of Internal Revenue, *vs.* Gooch Milling & Elevator Company. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[December 6, 1943.]

Mr. Justice Murphy delivered the opinion of the Court.

The jurisdiction of the Board of Tax Appeals[1] to determine and to apply a prior tax overpayment against a tax deficiency for a particular year is the sole question presented by this case. The Board held that it did not possess such jurisdiction, but the court below reversed, 133 F. 2d 131. We granted certiorari, 319 U. S. 737, the problem being one of importance in the administration of the revenue laws.

An audit made in 1938 of the books of the respondent corporation disclosed an erroneous valuation of its inventory of June 30, 1935.[2] Because of this error, respondent had been overassessed and had overpaid its income and excess profits taxes for the 1935 fiscal year. This excess payment was not subject to refund because barred by the statute of limitations. On the basis of the adjusted inventory, however, the Commissioner determined that there was a tax deficiency for the 1936 fiscal year. The overpayment of the prior fiscal year exceeded the amount of this deficiency. On appeal to the Board for a redetermination of the deficiency, the respondent sought in its amended petition to have the 1935 overpayment applied as an offset or recoupment against the 1936 deficiency. The

[1] Section 504(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 957, changed the name of the Board of Tax Appeals to The Tax Court of the United States. Section 504(b) provided that this change in name was to have no effect on the jurisdiction, powers and duties of the agency. See also H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172-173.

[2] The respondent filed its tax returns on the basis of a fiscal year ending on June 30. The inventory of June 30, 1935, was common to successive years, being the closing inventory for the 1935 fiscal year and the opening inventory for the 1936 fiscal year.

Board, consistent with its past decisions,[3] refused to grant this relief "for jurisdictional reasons."

We hold that the Board's position was correct and that it had no jurisdiction to determine or to apply any overpayment of the taxes for the 1935 fiscal year against the 1936 deficiency.

The Board is but "an independent agency in the Executive Branch of the Government,"[4] and the legislative pattern of its jurisdiction is clear and unambiguous. The Board is confined to a determination of the amount of deficiency or overpayment for the particular tax year as to which the Commissioner determines a deficiency and as to which the taxpayer seeks a review of the deficiency assessment. Internal Revenue Code, §§ 272, 322(d). It has no power to order a refund or credit should it find that there has been an overpayment in the year in question. *United States ex rel. Girard Trust Co.* v. *Helvering*, 301 U. S. 540, 542. Section 272(g) of the Internal Revenue Code specifically provides that "the Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid."

The Board's want of jurisdiction to apply the doctrine of equitable recoupment in this case is manifest from these statutory provisions. The Commissioner assessed a deficiency only for the 1936 fiscal year and it was this assessment of which the respondent sought a review. The Board thus had jurisdiction to do no more than redetermine the 1936 deficiency distinct from any overpayment or underpayment in any prior or subsequent year. There was no occasion here for the Board to exercise its power under § 272(g) to consider any facts relating to the taxes for the 1935 fiscal year.[5] The redetermination of the tax liability for the 1936

[3] See, for example, Appeal of R. P. Hazzard Co., 4 B. T. A. 150; Appeal of Cornelius Cotton Mills, 4 B. T. A. 255; Appeal of Dickerman & Englis, Inc., 5 B. T. A. 633; B. T. Couch Glue Co. v. Commissioner, 12 B. T. A. 1321; Gould-Mersereau Co., Inc. v. Commissioner, 21 B. T. A. 1316; Heyl v. Commissioner, 34 B. T. A. 223; Red Wing Potteries, Inc. v. Commissioner, 43 B. T. A. 841; Elbert v. Commissioner, 2 T. C., No. 113.

[4] 53 Stat. 158, 26 U. S. C. § 1100.

[5] The Board has not hesitated to exercise its jurisdiction under § 272(g) to consider the taxes for other taxable years insofar as relevant to the correct redetermination of the deficiency in question. See Evens & Howard Fire

fiscal year was in no way dependent on any prior tax assessment or overpayment. Likewise, neither the fact that the prior overpayment could no longer be refunded nor the fact that the overpayment exceeded the amount of the deficiency had any relevance whatever to the redetermination of the correct tax for the 1936 fiscal year. The respondent, in other words, was seeking to have the 1935 overpayment used, not as an aid in redetermining the 1936 deficiency, but as an affirmative defense or offset to that deficiency.[6] This necessarily involved a determination of whether there was an overpayment during the 1935 fiscal year. The absolute and unequivocal language of the proviso of § 272(g), however, placed such a determination outside the jurisdiction of the Board. Thus to allow the Board to give effect to an equitable defense which of necessity is based upon a determination foreign to the Board's jurisdiction would be contrary to the expressed will of Congress.[7]

We are not called upon to determine the scope of equitable recoupment when it is asserted in a suit for refund of taxes in tribunals possessing general equity jurisdiction. Cf. *Bull* v. *United States*, 295 U. S. 247; *Stone* v. *White*, 301 U. S. 532. But its use in proceedings before the Board is governed by the circumscribed jurisdiction of that agency. The Internal Revenue Code, not general equitable principles, is the mainspring of the Board's jurisdiction. Until Congress deems it advisable to allow the Board to determine the overpayment or underpayment in any taxable year other than the one for which a deficiency has been assessed, the Board must remain impotent when the plea of equi-

Brick Co. *v.* Commissioner, 8 B. T. A. 867; Commercial Trust Co. *v.* Commissioner, 8 B. T. A. 1138; D. N. & E. Walter & Co., Inc. *v.* Commissioner, 10 B. T. A. 620; J. C. Blair Co. *v.* Commissioner, 11 B. T. A. 673; Greenleaf Textile Corp. *v.* Commissioner, 26 B. T. A. 737, affirmed 65 F. 2d 1017; W. M. Ritter Lumber Co. *v.* Commissioner, 30 B. T. A. 231, 277.

[6] As we said in Bull *v.* United States, 295 U. S. 247, 262, "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded."

[7] Before § 272(g) of the Internal Revenue Code was enacted, the Board held that it had jurisdiction to determine an overpayment for a year as to which no deficiency had been found by the Commissioner and to apply that overpayment against the liability for the year as to which he had found a deficiency, thus giving effect to the doctrine of equitable recoupment. Appeal of E. J. Barry, 1 B. T. A. 156. Soon thereafter, however, Congress passed § 274(g) of the Revenue Act of 1926 [now § 272(g) of the Internal Revenue Code] taking such jurisdiction away from the Board.

table recoupment is based upon an overpayment or underpayment in such other year. The judgment of the court below is therefore reversed and that of the Board of Tax Appeals is affirmed.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.